INITIAL STATEMENT OF REASONS

Proposed Amendments to Title 2, Sections 561 through 561.14
CalPERS Member Home Loan Program

Description of Public Problem, Administrative Requirement, or Other Considerations or Circumstance that the Regulation is Intended to Address:

Title 2, Sections 561-561.14 of the California Code of Regulations interpret and implement the CalPERS Member Home Loan Program authorized by Section 20200 of the Government Code.

The Member Home Loan Program was conceived by various assembly bills dating from 1979. Regulations supporting the program were approved by the CalPERS Board of Administration ("Board"), then by the Office of Administrative Law and became effective June 17, 1981. The nature of the mortgage industry necessitates that the Member Home Loan Program's regulations be updated from time to time.

Specific Purpose

CalPERS Board of Administration ("Board") proposes to amend various regulations in order to update the governance of the program to reflect the current mortgage industry environment while clarifying the program's administration.

Statement of Reasons
The Board seeks to amend various regulations for the following reasons:

1) Clarify that non-conforming loans owned by CalPERS may be modified.

   In March 2009, the federal government implemented Making Home Affordable in response to a nationwide housing crisis. Part of this program involves offering loan modification opportunities to help keep home owners in their homes. Making Home Affordable provides CalPERS members who obtained real estate loans which were subsequently securitized into Fannie Mae or Freddie Mac loans with these opportunities. Adding loan modification language to Section 561.1 clarifies that CalPERS may offer temporary loan payment relief to members with non-securitized loans.

2) Clarify the program is for all CalPERS members and not just "currently employed members".

Section 561 of the Regulations currently uses the phrase "Currently Employed Member and Annuitant Single Family Home Loan Program". In contrast, Section 20200(d) of the Government Code permits and cites the program as "the Dave Elder Public Employees' Retirement System Member Home Loan Program".

Further, Section 20200(b) of the Government Code states that the term "member" means "any person who is receiving, or is entitled to receive, a retirement allowance funded by this system, the Legislator's Retirement System, the Judges' Retirement System, or the Judges' Retirement System II…". Some borrowers, by virtue of their prior state service, have earned retirement benefits and hence are considered "members" based on the above definition.

Amending Sections 561-561.3 of the regulations would remove ambiguity in the regulations.

3) <u>Clarify that the loans are available for home purchases as well as refinancing.</u>

The existing regulations are silent regarding the availability of real estate financing to members seeking to refinance their existing loan. However, Section 20200(c)(4) of the Government Code states that "home loans shall be available only for the purchase or refinancing of homes throughout the United States…".

Amending the regulations would bring greater clarity and consistency between the statute and the regulations.

4) <u>Define that home loan interest rates shall be set according to competitive market rates rather than set by the Investment Committee.</u>

Regulation 561.5 currently states that "Loans shall carry interest rates which shall be set in advance, from time to time, by the Board's Investment Committee".

At the inception of the program, CalPERS staff would recommend to the Board competitive interest rates based on a market survey of lenders. Initially, recommendations were made monthly. In October 1981, the Board's Investment Committee directed staff to make quarterly recommendations. In March 1991, Lomas Mortgage USA, as manager of the Member Home Loan Program, introduced a formal pricing model to help determine daily par interest rates on conventional loans. Revisions to this model were subsequently made to keep Member Home Loan Interest rates competitive. Under the auspice of the Board's Investment Committee, formal pricing models such as this, along with competitive pricing surveys of private sector lenders, have been employed since.

Amending Section 561.5 of the regulations to define that interest rates shall be set according to competitive market rates is consistent with Section 561.1 of the regulations, which states: “Loans issued pursuant to these regulations shall provide the greatest benefit to (members) consistent with the Board’s role as fiduciary for all members and annuitants…”.

5) <u>Update references from specific government agencies to “government-sponsored enterprises that guarantee loans” to allow for changes in federal governance.</u>

Amending Section 561.4 of the Regulations recognizes the changing nomenclature of federal governance of mortgage institutions.

6) <u>Provide that mortgage insurance requirements conform to government-sponsored enterprise’ guidelines.</u>

Mortgage insurance requirements help protect government-sponsored enterprises against default risk. Mortgage insurance companies, for a fee, offer “first loss” protection to government-sponsored enterprises. The amount of insurance coverage and corresponding fee premiums are established by the mortgage insurance companies. Typically, as loan-to-values increase, so do coverage requirements and insurance premiums.

For securitized loans, the amount of mortgage insurance does not increase default risk to CalPERS as investor. CalPERS is protected from default risk by the guarantee fees paid to the government-sponsored enterprises.

Amending Section 561.8 of the Regulations would enable CalPERS to offer its members loans consistent with government-sponsored enterprise’s underwriting guidelines which change from time to time.

7) <u>Extend the allowable length of a loan beyond 360 months to facilitate loan modifications.</u>

In March 2009, the federal government implemented Making Home Affordable in response to a nationwide housing crisis. In an effort to keep people in their homes, government-sponsored enterprises offer loan modification opportunities which reduce homeowners’ monthly mortgage payments. Currently, in addition to reducing the loan’s interest rate and deferring principal balances, the underwriting guidelines allow mortgage servicers to extend the loan's term to up to a maximum 480 months.

Amending section 561.9 would allow CalPERS more flexibility in implementing loan modification programs.

8) Delete loan prepayment penalties.

Currently, existing Section 561.10 of the Regulations provides that "Loans shall be subject to the prepayment penalties in effect as of the date the loan is closed as set forth in the Board's real estate mortgage loan standards which may be formally changed from time to time".

Prepayment penalties are not an industry standard. Eliminating this regulation will allow the Member Home Loan Program to be in line with current industry standards.

9) Clarify that correspondent lenders are bound by their agreement with CalPERS rather than a specific Board approved document.

When the Member Home Loan Program was enacted in 1981, correspondent lenders were bound by loan standards and documents approved by the Board.

Staff monitors the mortgage industry, implements program changes to conform to industry standards, and communicates these changes to correspondent lenders which are obligated to abide by these changes. This change to existing section 561.11 clarifies that correspondent lenders are bound by their agreement with CalPERS rather than a specific Board approved document.

10) Provide for Board delegation of the Member Home Loan Program's administration beyond ministerial duties.

Currently, existing Section 561.14 restricts the Executive Officer to delegating to subordinates only the ministerial functions of the Member Home Loan Program. This language stems from the early 1980's when the program was first implemented.

Deleting existing Section 561.14 would enable CalPERS Board of Administration to expand staff's scope of delegated authority, consistent with CalPERS other programs.

Technical, Theoretical and/or Emperical Studies, Reports or Documents:

Not applicable

Alternatives to the Regulatory Action and CalPERS' Reasons for Rejecting Those Alternatives:

Not applicable

Alternatives to the Regulatory Action that Would Lessen any Adverse Impact on Small Businesses:

The proposed regulatory actions have no cost impact on either small businesses or on persons in the private sector.